



The Commonwealth of Massachusetts

DEPARTMENT OF PUBLIC UTILITIES

January 9, 2008

D.P.U. 07-49

Petition of River Run Condominium Trust for ruling on whether tax credits may be included in determining the net cost of energy efficient equipment under the guidelines for Energy Efficiency Programs, as approved in D.T.E. 98-100 and established by G.L. c. 25, § 19.

I. INTRODUCTION

On June 7, 2007, River Run Condominium Trust (“River Run” or “Petitioner”) filed with the Department of Public Utilities (“Department”), a petition for a ruling (“Petition”) on whether, in administering gas and electricity energy efficiency programs, distribution companies should include any tax credits that may be available to customers when calculating the net cost of energy efficient equipment. The Department docketed this matter as D.P.U. 07-49.

Pursuant to notice duly issued, the Department sought initial comments and reply comments on River Run’s Petition. The Department received initial comments on July 27, 2007, and reply comments on August 16, 2007.¹ The following entities submitted comments: the Attorney General of the Commonwealth of Massachusetts (“Attorney General”); Bay State Gas Company (“Bay State”); City of Northampton; Massachusetts Division of Energy Resources (“DOER”); KeySpan Energy Delivery New England (“KeySpan”); and Solar Energy Business Association of New England (“SEBANE”).

¹ The Department solicited reply comments that addressed two specific issues:

(1) Are there other types of credits and revenue sources (e.g., public or private grant funding) that should also be included in the determination of the net cost of energy efficiency equipment? If so, what criteria should the Department use to determine which credits and revenue sources are appropriate for inclusion?

(2) What type(s) of supporting documentation should an applicant be required to submit to a program administrator in order to demonstrate that the participant is eligible, and has taken the necessary steps, to receive the identified credit(s)?

II. DESCRIPTION OF THE ISSUE

River Run is a residential condominium association that is prepared to construct a series of thermal solar panels to pre-heat domestic hot water and reduce overall natural gas consumption (Petition at 1). River Run seeks to qualify for funding from Bay State Gas Company as an energy efficiency project (id.). River Run proposes to install approximately 200 solar thermal panels at a cost of approximately \$289,000 in order to save an estimated 17,000 therms per year (Bay State Initial Comments at 1). According to Bay State, River Run's project does not qualify for funding under the established cost-effectiveness test (id.). As a result, River Run now seeks a ruling from the Department on whether, in determining the net cost of energy efficient equipment, distribution companies should take into account state and federal tax credits for renewable energy technologies that are available to customers. Specifically, River Run requests that the Department rule that, in calculating the cost-effectiveness of a renewable energy project, distribution companies should calculate the net cost of project equipment by deducting the amount of the tax credit, rather than using its 100 percent initial cost (Petition at 3).

In making this argument, River Run relies on the Guidelines for the Methods and Procedures for the Evaluation and Approval of Energy Efficiency Programs ("Guidelines"), established in Investigation Into Energy Efficiency Programs, D.T.E. 98-100 (2000). The Guidelines establish, among other things, the manner in which gas local distribution companies and electric distribution companies (together, "Companies") shall calculate the costs associated with the implementation of energy efficiency programs to determine the cost-effectiveness of

each program. Guidelines at Section 3.1. The Guidelines currently state that program costs shall include all expenses incurred by participants, including the “net cost of energy efficient equipment.” Id. at Section 3.2.3. In general, any program with a benefit-cost ratio of greater than 1.0 (where the benefits of the program outweigh the costs) qualifies for energy efficiency funding from the Companies as a demand-side management (“DSM”) program. Id. at Section 3.5. This energy efficiency funding is collected from all ratepayers to fund DSM programs, pursuant to G.L. c. 25, § 19. River Run claims that, if its request is granted, the benefit-cost ratio of the project will become 1.20 instead of 0.71, which means that it would meet the minimum threshold for DSM funding (Bay State Initial Comments at 5).

III. SUMMARY OF THE COMMENTS

A. Bay State

Bay State asserts that, to date, it has interpreted the Guidelines to capture all costs, and not only the participant’s net costs (id. at 3). Bay State cautions the Department to weigh all considerations before making the ruling requested by River Run, and identifies what it considers to be important factors (id.).

Bay State argues that the existence of tax credits sways the balance of benefits strongly in favor of participants (id. at 4). Bay State states that a tax credit is a transfer payment from non-participants to participants, because it represents a revenue shortfall to the federal or state government, and ultimately, a liability for other citizens (id.). Bay State disagrees with the Petitioner’s assertion that failure to include tax credits would block funding for renewable technologies, or make it unlikely that a renewable energy project would ever receive energy

efficiency funding from the Companies (id.). Bay State argues that not all project applications should receive funding, and funds should be allocated to the most cost-effective projects (id.). Bay State asserts that, because River Run's project requires the incorporation of available tax credits as an offset to reach a benefit-cost ratio of more than 1.0, which is essentially a "write-down" of the project costs, the project is not as cost-effective as other similarly situated measures (id.). Also, Bay State argues that, contrary to River Run's assertion, the Department is not required to define "costs" with regard to the cost-effectiveness of energy efficiency programs as directed by the Massachusetts Tax Code (id. at 7). Bay State suggests conducting River Run's project as a demonstration or market transformation project to be compared with more traditional utility DSM programs (Bay State Reply Comments at 2).

Bay State also identifies a number of practical difficulties posed by River Run's proposal. Bay State asserts that it fully supports customer efforts to take advantage of energy efficiency funding, along with the following types of revenue: (1) state and federal tax credits; (2) government and foundation grants, including the Massachusetts Renewable Energy Trust; (3) federal, state, and municipal economic development programs; (4) environmental impact/improvement programs; and (5) other incentive payments (Bay State Reply Comments at 1). Bay State states that it is not, however, in a position to determine customer eligibility for each funding source on a case-by-case basis, nor has it committed the resources to research and identify all potential revenue sources for all high-efficiency and renewable energy technology and equipment (id.). Bay State states that it is unclear how any or all of these credits, rebates, or revenue sources should be used when designing its energy efficiency

programs (id.). Bay State claims that it would incur substantial administrative expenses to evaluate the effect of anticipated tax benefits on the cost-effectiveness of its energy efficiency programs (id. at 6). Bay State notes that it is unclear, both in River Run's specific case and in general, whether and to what extent entities actually qualify for tax credits (id.). Bay State asserts that reviewing tax returns to establish cost-effectiveness of a project is beyond the scope of its business, but suggests that an affidavit from a certified public accountant ("CPA") may be sufficient (id.). Bay State recommends reviewing the issue of appropriate documentation of applicable funding sources at a technical session (id.). In conclusion, Bay State generally opposes River Run's proposed interpretation of the Guidelines.

B. KeySpan

KeySpan states that, to date, it has not interpreted the Guidelines as incorporating tax credits available to program participants into a cost-benefit analysis (KeySpan Comments at 2).² KeySpan further states that, before introducing a measure into its energy efficiency program, it does not evaluate individual projects for cost-effectiveness; instead, it determines that a measure is cost-effective in the context of the overall market on the basis of various studies (id.). KeySpan states that, as it performs its annual review of its programs, it may adjust or eliminate programs that are either only marginally cost-effective or not cost-effective at all, while attempting to identify, include, and promote new technologies, such as solar thermal applications (id.). KeySpan argues, however, that including tax credits and other transfer payments in cost-benefit analyses would likely result in: (1) an increase in measures

² KeySpan submitted comments on August 16, 2007 only.

that are renewable energy or only marginally cost-effective; and (2) measures that are not at all cost-effective will become so (id. at 2-3). KeySpan claims that this would reduce the overall cost-effectiveness of its programs, and as a result, the cost to ratepayers to achieve the same level of natural gas savings would increase (id. at 3).

With regard to practical considerations, KeySpan states that, as a program administrator, it is concerned that it could be required to verify both the project participant's filing and receipt of tax or other transfer credits (id.). KeySpan claims that verifying eligibility for tax credits could depend on filing status, tax liability, and other factors, and with respect to other types of transfer payments, similar verification steps could be required (id.). Further, KeySpan states that project participants, which include individuals and businesses, may be reluctant to provide this confidential tax information (id.). Also, KeySpan argues that it would be difficult to take into account specific tax credits or other transfer payments for a specific project in evaluating cost-effectiveness of an entire program. Accordingly, KeySpan would be forced to rely on estimates, thereby increasing uncertainty about the cost-effectiveness of its highly successful energy efficiency programs (id.). In conclusion, KeySpan does not endorse modifying or interpreting the Guidelines in the manner requested by River Run, absent a formal proceeding with all affected utilities (id. at 3-4).

C. Attorney General

The Attorney General addresses implementation issues only, and is silent as to whether or not River Run's Petition should be granted.³ The Attorney General states that River Run and future applicants should be required to certify, possibly through an affidavit, that they are reasonably certain to receive tax or other credits (Attorney General Letter at 1-2). The Attorney General also states that the Department should require an applicant to provide supporting documentation, such as a letter from a tax attorney or a ruling from the Internal Revenue Service, to demonstrate eligibility (*id.* at 2). Finally, the Attorney General states that the Department should require an applicant to certify that, in the event that the applicant fails to receive the anticipated credits, it will return any energy efficiency funds it receives (*id.*).

D. SEBANE

SEBANE supports River Run's Petition (SEBANE Initial Comments at 1). SEBANE claims that using "net costs" as the basis of a cost-benefit analysis will enable more renewable energy projects to qualify for funding from energy efficiency programs (*id.*). SEBANE claims that this will, in turn, increase the number of renewable energy projects installed in Massachusetts, which will: (1) create jobs in the renewable energy industry; (2) reduce energy costs; and (3) increase environmental benefits (*id.*).

E. City of Northampton

The City of Northampton fully supports establishing "net costs," which include tax credits, as the basis of a cost-benefit analysis for energy efficiency funding, because "net

³ The Attorney General submitted comments on August 16, 2007 only.

costs:” (1) represent true consumer costs; (2) provide the shortest payback period; and (3) encourage participation in energy efficiency programs (City of Northampton Initial Comments at 1). The City of Northampton states that, to promote consumer understanding, the Guidelines should be transparent and clear in determining eligible projects, cost/benefit analyses, and criteria reflecting the standards to qualify for energy efficiency funding from the Companies (id.). Also, the City of Northampton recommends that the Guidelines state that both energy efficiency and renewable energy projects are eligible for energy efficiency funding from the Companies (id.).

F. DOER

DOER recommends that the Department grant River Run’s Petition (DOER Initial Comments at 5-6). DOER states that, while the Department has not yet interpreted “net costs” in Section 3.2.3. of the Guidelines, an administrative agency is generally afforded the deference to interpret its own rules and regulations (id. at 3). DOER argues that the Department should interpret “net cost” to give full effect to the adjective “net” and allow the deduction of tax credits based upon: (1) the plain terms of the provision itself; (2) the inclusion of the term “net” as distinguishable from other references to costs; (3) the unlikelihood that the word “net” is superfluous; and (4) the ordinary meaning of the term (id. at 3-4). DOER also states that this would be consistent with Massachusetts energy policy because it will result in the installation of more renewable energy resources and produce a net benefit for Massachusetts (id. at 4-5). At present, DOER recommends that the definition of

“net cost” include only state and federal tax credits available at the time a project application is submitted (id. at 5-6).

With regard to implementation issues, if “net costs” were to become the basis for cost-benefit analyses of energy efficiency projects, DOER recommends that Companies allow energy efficiency funding applicants to reduce actual project costs in the same manner as is permitted under Section 45 of the Internal Revenue Code (DOER Reply Comments at 3).⁴ In addition to state tax credits, this would provide for the inclusion of: (1) federal and state grants; (2) proceeds of an issue of state or local government obligations used for financing when the interest is tax-exempt; (3) the aggregate amount of subsidized energy financing provided (directly or indirectly) under a federal, state, or local program provided in connection with the project; and (4) the amount of any other credit allowable with respect to any property which is part of the project (id. at 3-4). DOER also recommends that the Department, like the Internal Revenue Service, require project proponents to: (1) certify to program administrators that all information is true and accurate; and (2) maintain extensive backup documentation of all offsets to costs (id. at 4).

⁴ Section 45 of the Internal Revenue Code provides a tax credit for renewable energy sources and includes a list of offsets as the numerator of a more complex formula for calculating the price floor of electricity generated at qualified renewable facilities (DOER Reply Comments at 3). While DOER acknowledges that this list of offsets was promulgated for different purposes than the instant case, it believes that it would nonetheless be appropriate as a list of offsets in calculating the “net costs” of an energy efficiency project (id.).

G. River Run Comments

River Run states that, in determining the net cost of energy efficient equipment, it supports the inclusion of the following types of funding: (1) funding stemming from the Energy Policy Act of 2005; (2) state tax credits; (3) sales tax exemptions; (4) federal grants; (5) local grants; and (6) any other qualifying funding opportunities (River Run Comments at 1).⁵ River Run states that because the energy efficiency programs presently require customers to use a technical expert or Registered Professional Engineer to complete energy calculations and monetary savings, a CPA can provide documentation of a customer's financial and tax consequences, and reference the appropriate financial and tax code requirements (id. at 4). Also, River Run argues that a CPA can provide documentation as needed to confirm any grants or additional funding that a customer has received or may reasonably qualify for (id.).

IV. ANALYSIS AND FINDINGS

A. Consistency with the Total Resource Test

The Department addressed the evaluation of the costs and benefits of energy efficiency programs in Investigation Into Energy Efficiency Programs, D.T.E. 98-100 (2000). In that docket, the Department identified the range of costs and benefits resulting from energy efficiency programs, and recognized that some will accrue to: (1) the energy system; (2) the customers participating in energy efficiency programs; or (3) society as a whole. The Department considered three different tests by which the costs, benefits, and resulting cost-

⁵ River Run submitted reply comments on August 17, 2007, as amended on August 24, 2007.

effectiveness of energy efficiency programs could be evaluated: (1) the Energy System Test; (2) the Total Resource Test; and (3) the Societal Test. As the Department noted in D.T.E. 98-100, “a particular program may have a varying benefit-cost ratio depending on the test that is used to evaluate its cost-effectiveness.” D.T.E. 98-100, at 7 (November 3, 1999).

The Energy System Test is a relatively narrow assessment of the cost-effectiveness of energy efficiency programs. This assessment includes the costs and benefits that accrue to the energy system, such as the avoided costs of generation, transmission, and distribution (in the case of the electric system), and excludes all other costs and benefits.

Conversely, the Societal Test is the broadest assessment of program cost-effectiveness. This assessment includes costs and benefits to the energy system, participating customers, and society as a whole, including economic and environmental costs and benefits. The Societal Test would view tax credits as a transfer payment from taxpayers to program participants, and thus would view the net effect of tax credits as neither a cost nor a reduction in cost.

The scope of the Total Resource Cost Test falls between that of the Energy System Test and the Societal Test. This assessment includes costs and benefits that accrue to the energy system and program participants, but ignores other societal costs and benefits. Ultimately, the Department chose the Total Resource Cost Test as the appropriate test for analyzing cost-effectiveness. D.T.E. 98-100, at 15 (November 3, 1999).

With the scope of the Total Resource Cost Test in mind, we turn to River Run’s petition. Although tax credits represent transfer payments from taxpayers to energy efficiency programs, the resulting liability constitutes a societal cost outside the scope of the Total

Resource Cost Test. Because societal costs and benefits are excluded from the Total Resource Test, it is both proper and consistent to exclude the societal consequences of tax credits as well. Therefore, the Department finds that River Run's proposal to interpret "net cost of energy efficient equipment" from Section 3.2.3 of the Guidelines as incorporating tax credits in benefit-cost analyses is consistent with the Department's interpretation and application of the Total Resource Cost Test.

B. Appropriate Use of Energy Efficiency Funds

Some commenters claim that granting River Run's petition poses the risk of funding marginally cost-effective energy efficiency measures, which will increase the cost to ratepayers to achieve the same level of natural gas efficiency savings, and reduce the overall cost-effectiveness of programs (KeySpan Comments at 2-3). They argue that, because not all projects deserve funding, projects should be ranked for cost-effectiveness, and DSM funding should be allocated to the most cost-effective projects (Bay State Initial Comments at 4).

The Department does not find these arguments persuasive. First, these same arguments could be used to exclude several components of the Total Resource Cost Test that were accepted by the Department in D.T.E. 98-100 (e.g., customer benefits such as O&M savings, reduced consumption of fossil fuels or water, or low-income non-energy benefits). D.T.E. 98-100, at 16-17 (November 3, 1999).

Second, Massachusetts energy efficiency program administrators⁶ have long had an obligation to develop efficiency programs – and to decide whether to include or exclude certain efficiency measures – in a way that achieves a variety of state energy efficiency goals.⁷ The cost-effectiveness of an energy efficiency program or measure is only one of many objectives that must be balanced.

Furthermore, the Department recently articulated that gas distribution companies are required to implement “all cost-effective energy efficiency measures that are reasonably achievable.” Bay State Gas Company, D.T.E./D.P.U. 06-84, at 26 (2007).⁸ Consequently, an energy efficiency measure should not be excluded from programs merely because it has a

⁶ By “efficiency program administrators,” we are referring to the Massachusetts electric distribution companies, gas distribution companies and municipal aggregators that implement the energy efficiency programs funded by the system benefits charge.

⁷ The Massachusetts energy efficiency goals include: (a) strengthening the economy and improving the environment by increasing the efficiency of energy use; (b) reducing electricity use cost-effectively, and ensuring that funds are allocated equitably across customer classes, including low-income customers; and (c) reducing customer cost by balancing short-term and long-term efficiency savings, and supporting the development of competitive markets for energy efficiency. Guidelines Supporting the Massachusetts Division of Energy Resources Energy Efficiency Oversight and Coordination Regulation, 225 C.M.R. § 11.00 et seq.

⁸ The Department clarified that the Long-Range Forecast and Supply Planning process requires gas distribution companies to evaluate supply-side and demand-side resources on an equivalent basis, and to adopt those resources that result in a least-cost plan. To achieve these goals, gas distribution companies should implement all cost-effective gas efficiency measures that are reasonably achievable. D.T.E./D.P.U. 06-84, at 26. To help resolve any issues raised by this clarification, the Department proposed to initiate a series of technical conferences. D.T.E./D.P.U. 06-84, at 36.

lower benefit-cost ratio than another measure. Instead, all cost-effective efficiency measures should be evaluated for inclusion in gas distribution company efficiency programs.

C. Documentation of Tax Credit Eligibility and Receipt

In their comments, both Bay State and River Run concede that an affidavit from a certified public accountant (“CPA”) may be sufficient to document that River Run is eligible for the applicable federal and state tax credits for its proposed project (Bay State Reply Comments at 6; River Run Comments at 4). Based on this agreement, the Department concludes that, in this instance, an affidavit is an acceptable form of documentation for eligibility.

The Attorney General recommends requiring a program participant to certify that, in the event it fails to receive the tax credits, it will return any energy efficiency funds awarded (Attorney General Letter at 2). The Department adopts the Attorney General’s recommendation, in the instant case. In so doing, we note that the commenting LDCs have not indicated that such a requirement would be unduly burdensome. However, the Department notes that widespread adoption of efficiency measures supported by subsidies in the future could create burdensome or unnecessary administrative requirements on program administrators. Therefore, while we accept the Attorney General's recommendation at this time, we highlight this as one of the issues with respect to program implementation that the Department may need to review on a going-forward basis.

D. Conclusion

Accordingly, for all of these reasons, we determine that “Program Participant Costs” in Section 3.2.3 of the Guidelines, which are defined in part by the “net cost of energy efficient equipment,” should be interpreted to include applicable state and federal tax credits that reduce the cost of energy efficiency measures. We apply this interpretation in the instant case, however, the Department recognizes that this determination may raise additional issues related to energy efficiency measures and programs, including: other types of subsidies for inclusion; documentation required for subsidies to participants; effects on energy efficiency plans; and reporting of program benefit-cost ratios. We will address these issues, if necessary, at the appropriate time.

V. ORDER

Accordingly, after review and consideration, it is

ORDERED: That pursuant to the Guidelines established by D.T.E. 98-100, “net cost of energy efficient equipment” shall be deemed to include state and federal income tax credits.

By Order of the Department,

/s/

Paul J. Hibbard, Chairman

/s/

W. Robert Keating, Commissioner

/s/

Tim Woolf, Commissioner